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IN THE

Supreme Court of the United States

OCTOBER TERM, 1946

No. 690

INSURANCE GROUP COMMITTEE, REORGANIZATION COMMITTEE, GUARANTY TRUST COMPANY OF NEW YORK, Trustee, CENTRAL HANOVER BANK AND TRUST COMPANY, Trustee, UNITED STATES TRUST COMPANY OF NEW YORK, Trustee, and the CHASE NATIONAL BANK OF THE CITY OF NEW YORK, Trustee,

Petitioners,

vs.

THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY, *et al.*,

Respondents.

BRIEF OF THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY

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THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY, *et al.*,

Respondents.

BRIEF OF THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY*

Statement

This proceeding is before this Court on a writ of *certiorari* to review an Order of the United States Circuit Court of Appeals in the Tenth Circuit dated November 2, 1946 entered by Circuit Judge ORIE L. PHILLIPS which stays further action under an Order of the District Court for the District of Colorado dated November 29, 1944 confirming a Plan of Reorganization of the properties of The Denver and Rio Grande Western Railroad Company and its sub-

* The Respondent, The Denver and Salt Lake Western Railroad Company, a wholly-owned subsidiary, concurs in and adopts this Brief. Whenever reference is herein made to the Debtor it shall apply only to The Denver and Rio Grande Western Railroad Company unless otherwise stated.

sidiaries (Tr. fols. 31-32). The stay was granted to preserve the status of the litigation pending disposition of an appeal from an Order of the District Court dated October 30, 1946 (Tr. fol. 32). The Order of the District Court is one denying a Petition of the Respondents asking *inter alia* that the proceeding be referred back to the Interstate Commerce Commission for determination in the light of the revealed facts whether it should not formulate a new Plan of Reorganization (Tr. fols. 16-18). The Petition of the Respondents which in the Order of the District Court is characterized (we think erroneously) as a "Petition for Rehearing" is a Petition in the nature of a supplemental Bill revealing new and radically altered relevant economic conditions (Tr. fol. 4). The filing of such a petition as a matter of right for that purpose is authorized by the decision of this Court in *Atchison, Topeka and Santa Fe Railway Company* vs. *United States*, 284 U. S. 248, and other decisions hereafter cited.

Jurisdiction

The jurisdiction of the Circuit Court of Appeals to review the Order of the District Court is conferred by Section 24a of the National Bankruptcy Act (11 U. S. C. A. 47a). The authority of the Circuit Court of Appeals to stay proceedings in the District Court in order to preserve the status of the litigation pending exercise by it of its lawful appellate jurisdiction is inherent and is fortified by statutory enactment including U. S. Code, Sections 377 and 378, and National Bankruptcy Act, Section 2(13) and Section 24. Reference is here made to the opinion of Mr. Justice REED in the matter of the *Equitable Office Building Corporation* forming part of the record in this Court in connection with Petitions for *certiorari* in *Dana and Others* vs. *J. Donald Duncan, as Trustee*, Nos. 609-612 on the present Docket of this Court.

Question Presented

Mr. Justice REED in his opinion filed in the case last above cited in connection with the Order dated August 6, 1946 staying further proceedings for the reorganization of the Equitable Office Building Corporation says:

> "The effect of unanticipated changes of economic conditions after confirmation on the propriety of subsequent action by the reorganization court to protect the interests of junior creditors also has not been judicially determined finally. Compare *RFC* v. *Denver & R. G. W. R. Co.* 90 L. Ed. 1134, 1148; *Ecker* v. *W. P. R. Co.* 318 U. S. at 506-509."

In view of this very definite statement by the Justice of this Court who wrote the prevailing opinion in the pending proceeding released June 10, 1946, the Respondents assume that a writ of *certiorari* was granted to review the Order of the Circuit Court of Appeals for the purpose of bringing up that precise question for final determination by this Court. Since that stay Order was granted in the Tenth Circuit Petitions similar to that filed in the District Court have been filed in proceedings in the Eighth Circuit for the reorganization of the St. Louis-San Francisco Railroad Company and the St. Louis Southwestern Railway Company, in one of which there has been the denial of a stay. It is understood that similar Petitions have been or will be filed in proceedings in the Second and Seventh Circuits. The question now appears therefore to be one of general public interest in which several Circuit Courts may not be in accord.

Paraphrasing what is said in the above-quoted opinion of Mr. Justice REED the question presented to this Court is—

I

Does the Petition filed by the Respondents in the District Court disclose unanticipated changes of economic conditions of such character, magnitude and impact as to require reconsideration by the Interstate Commerce Commission of the Plan of Reorganization approved and confirmed by the Orders of the District Court which were affirmed and reinstated under the decision of this Court rendered June 10, 1946?

ARGUMENT

I

The Petition filed by the Respondents in the District Court discloses unanticipated changes of such character, magnitude and impact as to require reconsideration by the Interstate Commerce Commission of the Plan of Reorganization approved and confirmed by the Orders of the District Court which were affirmed and reinstated under the decision of this Court rendered June 10, 1946.

In developing the foregoing proposition in its natural subdivisions we shall utilize the captions—*A*, The Law; *B*, The Facts; and *C*, The scope of the decision of this Court rendered June 10, 1946.

A. The Law: It has always been the rule that notwithstanding the entry of a final judgment or decree the Court retains jurisdiction to do justice in a cause until the passing of the Term. A Bankruptcy Court, and this is expressly declared by subsection (a) to be applicable to a proceeding under Section 77 of the National Bankruptcy Act, is a court of equity with a continuous

Term so that even if an order of confirmation in such a proceeding were technically a final decree (which it is not) the District Court would not have lost power to set it aside in furtherance of right and justice. This is the clear import of the following authorities:

Dana and Others vs. *J. Donald Duncan, as Trustee* (*supra*);
Meyer vs. *Kenmore Hotel Corporation*, 297 U. S. 160;
Pfister vs. *Finance Corporation*, 317 U. S. 144.

In the case last cited Mr. Justice REED says:

> "Courts of bankruptcy are courts of equity without terms. * * *. The entire process of rehabilitation, reorganization or liquidation is open to reexamination out of time by the District Court in its discretion and subject to intervening rights."

The District Court did not deny the Petition of the Respondents for a reference of the proceeding back to the Interstate Commerce Commission either in the exercise of a judicial discretion or because of intervening rights but denied the Petition on the merits stating two grounds, neither of which (as the Respondents contend) is a valid one:

> "(a) that the Order of November 29, 1944 (confirmation) having become final, conclusively determines all controversies concerning the Plan and the rights of the various classes of security holders to participate and it is not now competent for the Debtor to reopen those proceedings; and
>
> (b) that the Petition for Rehearing fails to state a case which justifies reconsideration by thi Court of the issues already determined."

That the Order of confirmation is not a final determination is, we submit, thoroughly established by the authorities cited above and further discussion seems idle. Never-

theless it may be pertinent to refer this Court to statutory confirmation found in subsections (a), (f) and (g) of Section 77. Subsection (a) provides that the District Court shall have exclusive jurisdiction of the Debtor and its property wherever located and shall have and may exercise all powers which a Federal Court would have had it appointed a receiver in equity of the Debtor's property. The same subsection also provides that the Supreme Court of the United States shall promulgate rules which it may deem advisable in order to aid the District Courts and the Circuit Courts of Appeal in exercising jurisdiction conferred upon them.

Pursuant to this statutory authority this Court promulgated General Order XLIX relating to proceedings under Section 77. This provides in subsection (p) for a motion to dismiss the proceedings because of undue delay; in subsection (u) for an order confirming the plan (such was the order entered in this proceeding on November 29, 1944) and which is to be supplemented by any order directing the transfer or other disposition of the property; and finally subsection (v) for *"the final decree."*

Subsection (f) provides that upon the termination of the proceeding there shall be a *"final decree"* discharging the trustee or trustees and making such provisions as may be equitable by way of injunction or otherwise and closing the case.

Subsection (g) provides that if in the light of all existing circumstances there is undue delay in a reasonably expeditious reorganization the judge shall in his discretion after hearing and after consideration of the recommendation of the Commission dismiss the proceedings.

In addition to all of the foregoing statutory provisions making it perfectly clear that the order of confirmation is not only a preliminary step but is one that precedes by at least two steps what subsection (f) ordains as "the final

decree" we call this Court's attention to an express reservation in the order of confirmation in the present proceeding in the following language:

> "The Court retains full jurisdiction of this proceeding and of all parties in interest for the purpose of entering such other and further orders as may be appropriate."

In connection with this reservation of jurisdiction reference should be made to Sections Q and R of the Plan confirmed by the order of November 29, 1944, which Sections leave open for further judicial determination the method of discharge of the Debtor and the disposition of the Debtor's property to be made in advance of the final decree provided for in subsection (f). Until the Debtor is discharged the Court retains full, complete and exclusive jurisdiction under and pursuant to subsection (a) as well as the express reservation set out above.

The argument is made that the words used in the specific definition of the order of confirmation which are found in subsection (f) support the inference that the order of confirmation is a final order. It ought to be clear that the ancient basic jurisdiction of the Bankruptcy Court and no part thereof should be held to yield to an inference—especially since the inference runs counter to the express provisions of the same subsection which defers entry of "the final decree" until the closing of the case.

In the hearing in the District Court great stress was laid upon the circumstance that the Order of November 29, 1944 had been affirmed by this Court under a writ of *certiorari* to the Circuit Court of Appeals. That would be of significance if what is asked in the Petition runs counter to this Court's decision and to the mandate thereunder. Plainly it does not. What this Court decided was that on the record before the District Court on November 29, 1944 it had properly confirmed the Plan. Such decision did not

deprive the District Court of the judicial authority and control over the proceeding it would have had if there had been no appeal to the Circuit Court of Appeals from the Order of confirmation and no writ of *certiorari* to review the decision of the Circuit Court of Appeals. This Court has not, however, left such a question open or at large. On the contrary, this Court's own mandate is that "further proceedings be had in said cause as according to right and justice ought to be had, the said writs of *certiorari* notwithstanding."

One of the cardinal rules of equity is the rule that equity abhors a forfeiture. Equity speaks as of the date of its decree and does what is right and just not as of the date of the trial or the hearing but as of the date of the final determination of the cause. It is therefore a deep-rooted doctrine that the Chancellor will not enter a final decree or make any final disposition of an equity proceeding within his jurisdiction if the effect of conditions which have supervened since the record closed would render such decree or disposition unfair and inequitable or result in an avoidable forfeiture.

Reference is here made to the following supporting authorities:

Randal vs. *Brown*, 2 How. 406, 423;
Milwaukee and Minnesota Railroad Company vs. *Soutter*, 2 Wall. 510;
Graffam vs. *Burgess*, 117 U. S. 180, 192;
Atchison, Topeka & Santa Fe Railway Company vs. *United States*, 284 U. S. 248;
Central Kentucky Natural Gas Company vs. *Railroad Commission*, 290 U. S. 264;
United Corporation vs. *Federal Trade Commission*, 110 Fed. (2d) 473.

In addition to these early cases, we invoke the decisions of this Court in the cases of *Ecker* vs. *Western Pacific Railroad Corporation and Others*, 318 U. S. 448; and *Group of*

nstitutional Investors vs. *Chicago, Milwaukee, St. Paul and Pacific Railroad Company*, 318 U. S. 523, and the opinion of Mr. Justice REED in the instant case.

The application of this basic equitable principle in proceedings under the reorganization provisions of the National Bankruptcy Act presents special problems.

In the case of *Interstate Commerce Commission* vs. *Jersey City*, 322 U. S. 503, Mr. Justice JACKSON makes it clear that there must be a change as distinguished by a mere fluctuation and that in an administrative proceeding it does not extend to changes incidental to the normal lag or gap between the closing of the record and the time that the administrative order is promulgated. In the present proceeding Mr. Justice REED in the Opinion released June 10, 1946 excludes changes which were envisaged. Obviously no general rule can be laid down for the determination of collateral questions of this character. They must be determined in the light of the facts and surrounding circumstances of each case. A more liberal rule would be indicated for a judicial proceeding where there is a direct taking of private property than for an administrative proceeding where the impact is indirect and the principle of *res adjudicata* is inapplicable. This distinction should be borne in mind in connection with the decisions of this Court which are asserted to limit the application of *Atchison, Topeka and Santa Fe Railway Company* vs. *United States* (284 U. S. 248) and *Central Kentucky Natural Gas Company* vs. *Railroad Commissioners*, 290 U. S. 264.*

So far as it is possible to develop a broad rule which never is to come into play except in unusual and unforeseen circumstances, we think the authorities cited above support the following generalization—

* *United States* vs. *Northern Pacific Railway Company*, 288 U. S. 490; *St. Joseph Stock Yards Company* vs. *United States*, 298 U. S. 38; *Baltimore and Ohio Railroad Company* vs. *United States*, 298 U. S. 349; *Interstate Commerce Commission* vs. *Jersey City*, 322 U. S. 503; *United States* vs. *Pierce Auto Freight Lines, Inc.*, 327 U. S. 515.

Whenever an economic change occurs which is "cataclysmic"; which renders unfair and unjust a determination theretofore fair and just; and which forfeits the property belonging to one party and irrevocably gives it to another party, unjustly enriching the one to the detriment of the other, the rule that equity speaks as of the date of its final determination of the cause should apply in full vigor to avert such a forfeiture.

That some change was considered when the earlier determination was made ought not to be enough to bar an application of the rule unless the change be one that was envisaged as within the range of reasonable and definite expectation. Equity does not develop limitations to stifle its own conscience.

B The Facts: Since the facts alleged in the Respondents' Petition were susceptible of proof notoriously available—much of it already having been developed by the Interstate Commerce Committee of the United States Senate—the Petitioners elected to contest the Petition solely on the questions of law raised by a motion to dismiss the Petition (Tr. fols. 13-15). The District Court denied the Petition on the two grounds stated above, (i) finality of the Order of confirmation and (ii) want of equity (Tr. fol. 16).

The Plan of Reorganization for the properties of the Respondents which eliminated 90% of the investment of the Debtor's General Mortgage Bonds; made no provision for $17,000,000. of Preferred Stock; and declared worthless all of the Debtor's Common Stock was certified to the District Court by the Interstate Commerce Commission on June 14, 1943 and was based upon a record formally closed on May 20, 1941 (Tr. fols. 4, 9, 12). The Plan was approved by the District Court by Order dated October 30, 1943 and was confirmed by the District Court on November 29, 1944 (Tr. fol. 5). The Petition of the Respondents asking that

.he proceeding be referred back to the Interstate Commerce Commission for a new non-forfeiture Plan was filed in the District Court on September 17, 1946 (Tr. fol. 12).

The elapsed time between the closing of the record and the filing of the Respondents' Petition was five years, three months and twenty-seven days. This period, far from reflecting a normal lag is of sufficient length alone to create a legal presumption of obsolence—a circumstance which is aggravated against the Petitioners in this case because much of the delay was due to the fact that they were quarreling among themselves over the division of the spoils. We think there would be something wrong with a system of jurisprudence which permitted confiscation on a grand scale to be put into effect on the basis of fact-findings of an administrative body five years, three months and twenty-seven days old without giving that administrative body a chance to review and correct its own findings and protect itself against such excoriating criticism as appears in the Report of the Senate Committee on Interstate Commerce on Senate Bill 1253—(Rep. No. 1170, Calendar No. 1190, Seventy-Ninth Congress, Second Session).

The Respondents, however, base their Petition upon economic changes which have progressively developed since the Plan of Reorganization was certified to the District Court and in a very large measure *since* the Order of confirmation entered November 29, 1944, namely:

(a) The decline in money rates to a level far below those prevailing when the Plan of Reorganization was certified in the District Court,

(b) The recent public offering by the Government and the purchase by private capital for private operation of .ne steel plant at Geneva, near Provo, Utah which had been constructed by the Government in the exigencies of the war

at a cost in excess of $200,000,000.—more than the value the Commission itself attributed to the entire Denver and Rio Grande Western Railroad System;

(c) A permanent elevation of the national income through intensified industrial activity involving for the indefinite future a greatly increased demand for railway transportation (Tr. fols. 5-7).

Each of these major economic changes isolated from the others and standing alone is of sufficient magnitude and impact as to require a new Plan of Reorganization for the Debtor in which it is given due recognition.

We shall discuss each briefly.

(i) Decline in Money Rates:

The Plan of Reorganization certified to the District Court on June 14, 1943, assumed that a Bond secured by a senior rail lien should yield 4% in order to be worth par. That that was true on May 20, 1941 when the record was closed in the Interstate Commerce Commission is not questioned. Money rates eased gradually between that date and the date of certification but there was no cataclysmic change until after the Plan was out of the Interstate Commerce Commission and in the Court. Then the change came with dramatic suddenness in 1944. At the end of that year Chicago and Northwestern Railway Company called in its 4% Bonds which had been outstanding only seven months and refinanced on a 3% basis. That is to say, by reason of the drastic change in the cost of money the corporate earning power of that property had been put at a level at least 25% below what it should have been with the result that the permissible over-all capitalization put at $430,000,000 was understated by at least $100,000,000. This refinancing was followed in rapid succession by a series of refinancings, of which the following are scheduled in the Respondents' Petition (Tr. fol. 9):

Name	Date of Refinancing	Interest rate of Old Issue	Interest rate of New Issue
Chicago, Burlington and Quincy R. R. Co.	Aug. 1-Dec. 1, 1944	4%-5%	3½% 1½% 3¾%
Chicago and Northwestern Railway Co.	Jan. 1, 1945	4%	3%
Pennsylvania Railroad Company	Jan. 1, 1945	4½%	3⅛%
Pere Marquette Railroad Co.	Mar. 1, 1945	4%-5%	3⅜%
Wabash Railroad Company	Feb. 1, 1945	4%	3¼%
Washington Terminal Co.	Feb. 1, 1945	3½%-4%	2⅝%
Erie Railroad Co.	Jan. 1, 1945	4%	3⅛%
Erie Railroad Co.	Mar. 15, 1945	3⅛%	2%
Reading Company	Apr. 1, 1945	4%-5%	3⅛%
New York Connecting R. R.	Oct. 1, 1945	3½%	2⅞%
Lehigh & New England R. R.	Nov. 1, 1945	4%	3%
Western Maryland Railway	Nov. 1, 1945	5½%	1¾%-3¼%
Pennsylvania, Ohio and Detroit R. R. Co.	Oct. 1, 1945	3¾%-4½%	2⅞%
Term. R. R. Ass'n of St. Louis	Oct. 1, 1945	3⅜%-4%	2⅞%

In connection with the definite and permanent change in the rate level for the hire of money and the use of capital the Respondents' Petition incorporates by reference certain Congressional documents including Report No. 1170 of the Senate Committee on Interstate Commerce which sets out an informative group of statistical tables under the caption "Changing Pattern of Debt in the United States" (Tr. fols. 9-11). These tables furnished by the Federal Reserve Board show that the radical reductions upon which the Respondents rely are not limited to fixed interest bearing debt but extended to income bonds, preferred stocks and all of the securities that enter into the capital structures of our American railways. The following is an excerpt from that Report:

> "In 1946, the coupon rates are dropping fast, even below the 1945 rates, so that bonds refunded in

the autumn of 1945 are being refunded to lower coupon rates in the first months of 1946. So rapid is the decline in interest rates that railroad refunding bonds created a few months ago are themselves being refunded even before their first interest coupons fall due.

One example is furnished by the Southern Pacific, which in February 1946 refunded on a 2⅞ percent-coupon basis bonds it created 5 months earlier bearing a 3¾ percent coupon rate, which themselves were issued to refund previously created bonds bearing a higher coupon rate.

The Union Pacific recently sold a large bond issue at an interest cost to it of approximately 2½ percent."

(Report No. 1170 of Senate Committee on Interstate Commerce, Calendar No. 1190, Seventy-Ninth Congress Second Session, pages 24-30.)

The statistics set forth in this report and furnished by the Federal Reserve Board are amazing. Their present significance is made clear by the following items of testimony given at the hearings on S 1253 in the Senate Committee on Interstate Commerce by Vice President Purcell of the Allegheny Corporation and Mr. Charles D. Mahaffie of the Interstate Commerce Commission:

By Mr. Purcell:

"The Chairman. Most of the roads that are out of bankruptcy have refunded their bonds at a lower interest rate.

Mr. Purcell. Yes; that is a curious thing, too. Mr. Chairman, if I might comment on that for just a moment, the criterion under section 77 which is most frequently used in determining maximum capitalization is earning power. But let us assume that one of these railroads came out with $50,000,000 4 percent mortgage bonds and a month later they refinance them at 3 percent. There would be a saving of half a million dollars a year.

The Chairman. Yes; that was done.

Mr. Purcell. Yes.

The Chairman. They paid a dividend of 20 percent after they came out.

Mr. Purcell. I think they were committed to do that, in view of the fact that the effective date of the plan was about 4 years prior. Perhaps that was not right in itself but under the contractual obligations the corporation had to do that.

But my point is, if you then save $500,000 a year, that, capitalized at 5 percent is $10,000,000, which would properly have been added to the total capitalization of the railroad; but, in view of the fact that the reorganization has been completed with $10,000,000 of potential capitalization (unauthorized) even under the procedure provided under section 77, it has been lost to somebody."

By Mr. Mahaffie:

"The changes in credit conditions have now made those 4 percent first mortgage bonds of the roads that are covered by section 20c such that they generally can be readily refunded when the property is back in solvent condition. If they can be refunded at, say, 3 percent, that of itself, as Mr. Purcell indicated, affords a basis for an increase in capitalization, because the total of the fixed charges is one of the important elements in fixing capitalization. That and other changed conditions in these cases I think probably should have consideration where they can be shown to have changed to an important extent. It was with that in mind that I said if you are convinced, as I think you might well be, that these changed conditions should be looked into and evaluated, you might like, by statute, to send the proceedings in which you find them back for further consideration."

(Hearings before Senate Committee on Interstate Commerce on S 1253, Consolidated Print, pages 500-501; 520.)

Here is a very clear unequivocal admission on the part of Mr. Charles D. Mahaffie of the Interstate Commerce Commission that the recent changes in the money rates

have undermined the reorganization plans formulated by the Commission on the premise that 4% was the ruling minimum rate. But neither Mr. Purcell nor Mr. Mahaffie emphasized the further factor that the reduction in the rates for the hire money and the use of capital requires in testing the fairness of the plans formulated in the earlier economy a corresponding reduction in the rate used in capitalizing not only the increased income but all of the estimated income used as the factor to determine maximum capitalization. The Respondents' Petition alleges and the Petitioners admit that a reduction averaging 1½% in interest and dividend rates for capital structures set up prior to November 29, 1944 would be necessary to conform them to present-day security markets; that a reduction of 1½% in the interest and dividend rates prescribed in the Plan for the Debtor certified June 14, 1943 would involve an annual saving of $1,539,051 and that the resultant additional income capitalized at 3½% alone would provide for additional securities in the amount of $43,974,000—more than enough to make whole the holders of the Debtor's General Mortgage Bonds who are asked to forfeit more than 90% of their investment (Tr. fols. 9-10).

If there be any present-day virility in the traditional rule that equity abhors a forfeiture this proceeding should be sent back to the Interstate Commerce Commission to give that distinguished body an opportunity to back up by prompt corrective administrative action the testimony which Mr. Mahaffie gave to the Interstate Commerce Committee of the United States Senate.

(6) The Permanent Establishment of the Geneva Steel Plant:

The Geneva Steel Plant is the largest and most modern steel plant in existence. It was constructed as a war facility at a cost greater than the value attributed by the Interstate Commerce Commission to all the Debtor's properties. The

existence of this great traffic producing industry was given no weight at all when the Interstate Commerce Commission estimated the Debtor's earning power because at that time the plant did not exist and could not have been envisaged. On November 29, 1944, when the District Court confirmed the Plan now alleged to be obsolete it was unknown whether the plant would be closed down and written off as an expense item of the War or whether it would be sold as surplus property (Tr. fols. 10-12).

As late as February 28, 1946 Mr. Wilson McCarthy, Co-Trustee under Section 77 of the Debtor's property, testified before the Senate Committee on Interstate Commerce:

> "Now we were not dilatory in getting these plants on our lines. I am not saying we were responsible for getting them at all; we were not but we worked hard to get them and we have worked very diligently to retain the Steel Plant that we have got at Pueblo (meaning Provo). What its future is is purely problematical. Maybe it will go on. Maybe it won't."
>
> (Hearings before Senate Committee on Interstate Commerce, Consolidated Print, pages 335-336.)

The Respondents allege in their Petition that after the Plan of Reorganization for the Debtor's properties had been confirmed by the Court the Government decided to offer the Plant for sale as surplus property and in the month of June 1946 the property was acquired by the United States Steel Corporation which is now in possession; that the over-all purchase price was $47,500,000 plus an undertaking on the part of the purchaser to expend a minimum of $18,600,000 to adapt the plant to the manufacture of steel products in addition to those for which it was originally constructed (Tr. fols. 10-12). Coming back to the wholesome principle that equity abhors a

forfeiture it would seem that the very least a court of equity could do to avert the shocking forfeitures implicit in the Plan of Reorganization certified to it in this proceeding on June 14, 1943, is to give the Interstate Commerce Commission an opportunity to study the tremendous traffic possibilities of this great midwestern steel plant. We go further than this. We submit that it is the responsibility of the Court in the true performance of its duties under Section 77 to require that the Interstate Commerce Commission as the responsible fact-finding body under that Section determine whether and if so to what extent the commercialization of this new industry will enhance the permanent earning power of the Debtor's properties and thereupon revise upwards for the relief of junior and equity interests the depressed capital structure predicated upon obsolete pre-war earning experience.

(iii) The Post-war National Economy: It is impossible to say with precision when the pre-war economy ended and the post-war economy began. The transition happened long after the Plan of Reorganization was developed in the Interstate Commerce Commission and long after it was certified to the District Court. The most recent manifestation of the new economy was the permanent rate increase granted rail carriers by the Interstate Commerce Commission in *Ex Parte* 162. It cannot be gainsaid that our rail transportation system is performing its great public functions in a new economic era. If the passing into this new era did not render the Plan of Reorganization dating back to the old era obsolete *per se* then, at the very least, the transition rendered it too undependable to be used as the basis for the forfeiture of private property without further confirmatory findings by the Interstate Commerce Commission.

The Interstate Commerce Commission has taken the view that the Courts have held that post-war peacetime

conditions are not now relevant. The Commission appears to think that the Courts have decided that the post-war peacetime conditions which it visualized cannot be permitted to yield to the actual conditions which have materialized and are now provable. (Citing Report of Interstate Commerce Commission, Finance Docket No. 10008, St. Louis-San Francisco Railway Company, December 4, 1946).

Although the Debtor in that proceeding was not heard it had filed Objections to the final authorization of securities provided for in the previously certified Plan. The Commission said:

> "Objections were filed with us by the debtor with request for a hearing but these either go to matters not involved in the application or are similar to objections filed with and overruled by the Court."

The Objections "overruled" by the Court were Objections made prior to any possibility of demonstration of the newly established peacetime norm of National income and Debtor's gross income. In the Objections previously made to the Court the Debtor was able only to point out provable factors which in its view justified the prophecy that the new demonstrable post-war peacetime level of Debtor's gross income would be substantially what has now materialized.

Similar Objections have been made in this case. The Courts have ruled that the prophecy of the Commission must be accepted in preference to the prophecy of the Debtor. That, however, was in the absence of a contrary demonstration then impossible. We now in our Petition to the District Court in this case present for consideration not a prophecy but a present materialized provable post-war peacetime level of Debtor's gross earnings with all of its implications.

In holding that the Commission prophecy prevails over Debtor's prophecy do the Courts mean that when the Com-

mission prophecy is shown to be false the false must yet prevail over the true?

If not there is yet a duty for the Interstate Commerce Commission to perform and it cannot completely perform it if it approaches its task with the mistaken view that its previous mistaken prophecy is judicially crystallized and cannot be supplemented by today's demonstrable facts. It has been made clear that the Court cannot substitute its view of the weight of fact for that of the Commission. It is idle to ask the *Court* to revamp the Plan to conform to new conditions. This does not mean that the Plan is quarantined from supplementary consideration by the administrative body which has sole responsibility for its factual foundation.

We ask the Court to permit the Commission to consider the newly developed picture. We ask appropriate Court action to the end that the Commission may not rest under the error that it must adhere to its prophecy in the face of its demonstrated falsity.

We alleged in our Petition to the District Court *inter alia*:

> "A permanent elevation of the National income through intensified industrial activity involving for the indefinite future a greatly increased demand for railway transportation" (Tr. fols. 5, 6).
>
> "The reasonably anticipated gross income of Debtor's property for the year 1946 will be far in excess of any pre-depression income and on the basis of any operating ratio heretofore experienced on the property there should be realized therefrom distributable income far in excess of any amount necessary for the service of Debtor's obligations" (Tr. fol. 12).

These allegations we were prepared to prove but creditors moved for a summary dismissal. It was granted. Debtor appealed.

No opportunity to present evidence was given. The allegations stand as true. Elementary fairness seems to require that holding; if not we should be permitted to prove the allegations.

The Debtor was met with the argument that the District Court should take judicial notice of the stock market value of the Debtor's securities and that Dow-Jones averages on rails are now lower than on June 10, 1946.

If Justice CARDOZO in *Ohio Bell Telephone Company* vs. *Public Utility Commission*, 301 U. S. 292, correctly stated the law judicial notice is not available to a party except to support his position on an issue of fact. The unchallenged facts of our Petition are not refutable by judicial notice.

If judicial notice is to be resorted to (against which we protest) we point out the unfairness of the use of stock market quotations or averages to test the value of the Debtor's property. The core of the issue is the value assumed by the Commission. It begs the question to try and justify the Plan by reference to stock market quotations which reflect the wrong valuation incorporated in the Plan. These quotations are so tainted by various extraordinary factors which are not found in the usual market for a stock that they lose all validity. The Commission knows this.

We do not wish to avoid any issue or fact presented by our petition. We would cheerfully face that issue before the Interstate Commerce Commission and we would be alert to prevent misguided judicial notice from dispossessing facts.

We print as Appendix A a table showing the relationship for the years 1926-1945 inclusive between National income, the gross income of Class I Railroads and the gross income of the Debtor's railroad. Debtor's gross income is taken from the record in this case. The other data is all a matter of public record and mathematical computation.

1946 National income is not shown. It was not possible to give a fair estimate of that figure until after mid-year when the estimates of all governmental bodies including the Interstate Commerce Commission have furnished authentication of an estimate exceeding $160,000,000,000.

The Debtor's railroad is a transportation channel as necessary as light and air to the economy it serves. The volume of the flow of business to it automatically adjusts to the volume in its territory. Management may increase or decrease the flow by its efficiency or lack of it. But the modification of the ratio by management is within marginal limits. A glance at Appendix A tells the story.

The war years may be excluded because they were anomalous. They demonstrated no change in the pre-existing norm. The Debtor was fortunate in receiving a large share of high tariff governmental traffic. This distorted the ratios.

The lowest percentage of National income received by the Debtor was thirty-three one thousandths of one per cent. in the year 1941. Applying that to the governmental estimates of 1946 National income shows a gross income for Debtor in 1946 of more than $45,000,000. The actual 1946 System Gross (November-December partially estimated) is $50,500,000.

Using the presumption that "what is will continue," the Commission used the gross for depression years (around $25,000,000) as the basis for its future estimates and modified that basis slightly upwards. Now using the same presumption the estimate of Debtor's expected normal gross income should be in excess of $50,000,000. This being on the basis of the old rates would be higher on the rates fixed in Docket No. 162. In its best pre-depression year the maximum gross income was $35,000,000.

But what of the estimated net? It cannot be assumed that the Commission was arbitrary in making its estimate

of net earnings for the Plan. It had an historical record of operating ratios at near 75%-80% (over-all cost of operation). For the year 1946, the wage raises and higher material costs have increased the operating costs. This condition is as temporary and foreign to the norm of operating costs as the war income was foreign to the norm of gross income. There is no justification for using any but the historical ratios. If adjustments and economies do not restore those ratios the Commission has the power and duty to restore them by rate adjustment. The demand for the Debtor's service is now so great that rates may be raised without a loss of business to cancel the raise. This was not true during the thin business of the depression.

These are the matters which establish the *prima facie* case we wish to present to the Commission. They involve a status that has materialized and is provable. The Commission will be considering a railroad with $50,000,000 or more gross income and will have to consider new costs and the possibility of relief from present high costs by rate action or otherwise. At the time the Commission was formulating the Plan Debtor was treated as a railroad with a normal $25,000,000 annual gross with no possibility of increasing it by Commission action and no prospective favorable changes in operating costs.

The two contrasting problems are wholly different. The result must be different unless a new rationale is found to belittle the drastic improvement in Debtor's status. The right to be heard by the Commission is no clearer expressed than in *Atchison, Topeka & Santa Fe Railway Company* vs. *United States*, 284 U. S. 248, and *Central Kentucky Natural Gas Company* vs. *Railroad Commission*, 290 U. S. 264. The judiciary should not *frustrate* the Commission in the performance of its duty by denying the Debtor access to it. *'Alkali' Export Association* vs. *U. S.*, 325 U. S. 196.

C The Scope of the Decision of This Court Rendered June 10, 1946:

The decision of this Court rendered June 10, 1946 was upon a writ of *certiorari* to the Circuit Court of Appeals which had held that the General Mortgage veto of the Plan was effective to require its reference back to the Interstate Commerce Commission and ordered it so referred without prejudice. In an effort to contribute to a comprehensive consideration of the whole case the Debtor asked this Court for a writ of *certiorari*. A similar petition was filed by the Missouri Pacific Railroad Company, a stockholder. These petitions were not granted. Following the decision rendered June 10, 1946 a motion for rehearing afterwards supplemented was filed by the Debtor which was denied by this Court. A similar petition filed by City Bank Farmers Trust Company was also denied. The only question decided by this Court was that the General Mortgage veto was not effective and that the Plan of Reorganization on the record before it had been properly approved by the District Court.

At every stage of this proceeding through the appellate Courts and in the original and supplemental Petitions for Rehearing filed in this Court following the decision rendered June 10, 1946 the Respondents have asked that judicial notice be taken of the changes in economic conditions which underlie their Petition filed in the District Court on September 17, 1946. The Petitioners now urge that the failure of the Courts to grant relief was an adverse adjudication. We do not think this is a fair interpretation of this Court's opinion. Nor do we feel that the Respondents' zeal should be thus penalized. On the contrary we submit that the opinion shows an intent to leave open all questions as to the legal and practical effect of these significant economic changes; and this interpretation is supported by the opinion of Mr. Justice Reed rendered August 6, 1946 in the proceedings for the reorganization of the Equitable Office Building Corporation in which he says that very thing.

Since the scope of this Court's decision is peculiarly within the knowledge of this Court itself we feel that lengthy discussion is hardly appropriate but we shall deal with it briefly in connection with our:

Answer to Petitioners' Arguments

Almost all of the Petitioners' arguments are technical and opportunist. They seek to hold what they have regardless of the rugged rules of right and justice.

They say that the Respondents' Petition being one for a Rehearing is directed to the Court's discretion and is not appealable; that the order of confirmation is a final determination which cannot be set aside; and that the merits of the Petition were decided adversely by this Court in its decision of June 10, 1946, leaving the District Court without power to avert the forfeiture they concede to be imminent.

At the outset we have challenged their assertion to which the District Court seems to have yielded that the Respondents' Petition is a "Petition for Rehearing."

The Petition is one supplemental in nature based upon changed economic conditions filed to protect property rights from forfeiture and was filed as of right under authority of decisions of this Court of which *Milwaukee and Minnesota Railroad Company* vs. *Soutter* (2 Wall. 510, 522) and *Atchison, Topeka and Santa Fe Railway Company* vs. *United States,* (284 U. S. 248) are typical.

The case first cited is in principle indistinguishable. The Railroad Company had offered to show that as a consequence of changes occurring during the progress of the receivership it had regained its solvency and could and would liquidate its debts if the receiver were discharged. The Court denied this relief and the Railroad Company appealed to this Court, which reversed the Circuit Court. In this case Mr. Justice MILLER, after referring to various

questions determined in the course of a receivership which had been protracted, said:

> "But when those questions had been passed upon by the Circuit Court, and by this court also on appeal, and the amount of the debt definitely fixed by this court, the right of the defendant to pay that sum, and have a restoration of his property by discharge of the receiver, is clear, and does not depend on the discretion of the Circuit Court. It is a right which the party can claim; and if he shows himself entitled to it on the facts in the record; there is no discretion in the court to withhold it. A refusal is error—judicial error—which this court is bound to correct when the matter, as in this instance, is fairly before it."

In the present proceeding the Respondents allege and the Petitioners admit that as a consequence of cataclysmic economic changes it has regained its solvency at least to the extent that it can make all of its creditors whole.

Under these two decisions of this Court, the Circuit Court in the case first cited and the Interstate Commerce Commission in the other were held to have no discretion to deny relief such as the Respondents here seek and the denial was held to be a judicial error which the appellate Court is bound to correct.

Without reference to any facts other than the decline in interest and money rates the Petition offers the equity court an opportunity to avert a forfeiture of forty million dollars ($40,000,000) of junior debt which is wiped out under an unexecuted Plan based upon a record closed 5 years, 3 months and 27 days. We submit that if the District Court had any discretion (which it did not) the discretion was here abused to a point constituting patent judicial error. It is proper to point out, however, that the District Court did not attempt or purport to exercise discretion but denied the Petition as the consequence of its own determination of the justiciable legal questions which we have already discussed.

We do not think it would be helpful to discuss further whether the order of confirmation is a final decree. Even if it were a final decree (which the authorities already cited and subsections (a), (f) and (g) of Section 77 and General Order XLIX of this Court show it is not) it is an order or decree over which the District Court still exercises judicial control and may rectify in furtherance of right and justice within the letter and spirit of the mandate of this Court.

The Petitioners insist that the Opinion of this Court released June 10, 1946 foreclosed and withheld from the District Court the power to consider as a basis for corrective action the changed economic conditions set forth and alleged in the Respondents' Petition.

The Petitioners rely upon the following statements in this Court's opinion:

> "We note also the contention that the possibility of a National income much higher and interest rates much lower than before World War II should affect valuations based on prospective earnings. Those factors, we think, were before the Commission when it made its earnings estimate." (90 L. Ed. 1145.)
>
> "Nothing these respondents have called to our attention indicates any improvement in economic conditions or prospects in July 1944 or any date since even June 1943, the date of the approval of the plan which would justify a treatment different from that accorded the claimants in 1943." (90 L. Ed. 1154.)

The Respondents admit that the view thus expressed although falling far short of an adjudication that would put "closure" on the District Court was to them a disappointment raising in the mind of counsel a misgiving as to the adequacy of their own presentation. They easily understand, however, why this Court in the earlier months of 1946 would be hesitant to take judicial notice of a new and vastly improved economy when unrest was abroad

in the land, when strikes were in effect or threatened and imminent in all of our basic industries and when great wage increases already had granted in the railway industry and made retroactive to January 1, 1946 with little if any assurance that the Interstate Commerce Commission would approve increased rates sufficient to bridge the gap between prosperity and disaster. That this thought was dominant in the mind of this Court is brought directly into focus by foot-note No. 29 to the opinion of Mr. Justice REED.

This Court hesitated to send this proceeding back to the Interstate Commerce Commission for a new Plan without giving the proponents of the pending Plan an opportunity to present *factually* their view of the new economy. Accordingly this Court sent the proceeding back to the District Court for such further proceeding "as according to right and justice and the law of the United States ought to be had." Instead of meeting the issue by factual inquiry the Petitioners elected to rely upon the technical defenses we have already considered and discussed.

Enough in condemnation of what has occurred under Section 77 has been said in the Senate through the Reports of its Interstate Commerce Committee and in the House of Representatives by the Reports of its Judiciary Committee and by the President of the United States in Memorandum of Disapproval of the Wheeler-Reed Bill to invite an argument approaching closer the precepts of elemental justice.

Since it is our belief that the *writ of certiorari* was issued for the purpose of crystallizing the principles to apply in Section 77 proceedings where injustice may be done as the result of unenvisaged economic changes we are addressing ourselves to this problem in the hope of aiding a constructive solution.

It is to be noted that an ordinary equity case differs from a Section 77 proceeding in an important aspect; in

the equity case the Court is the judge of both the law and the facts whereas in a Section 77 proceeding the Court is "*brigaded*" with the Interstate Commerce Commission whose factual findings if reached by application of proper standards and not arbitrarily are conclusive.

After the Interstate Commerce Commission has made its findings and certified a Plan of Reorganization to the District Court its function has ended unless and until the proceeding is referred back to it by the Court which ordinarily only happens when the Plan is disapproved by the District Court or rejected by creditors. There is no express authority granted by Section 77 to the Court to refer the proceeding back to the Commission after a Plan has been approved or confirmed except such as is inherent in the provision of subsection (a) which declares that the Court shall have exclusive jurisdiction and control of the debtor and with all the powers of the judge in an equity receivership not inconsistent with Section 77. That the District Court was intended to have power to refer the proceeding back to the Interstate Commerce Commission for a special purpose is clear from the provision of subsection (g) which speaks of "the recommendation of the Commission" and we think this view is supported by the opinion of this Court in *Group of Institutional Investors* vs. *Chicago, Milwaukee, St. Paul and Pacific Railroad Company*, 318 U. S. 523—Opinion of Justice DOUGLAS, page 542.

In an equity receivership proceeding it would be for the Court to say as judge of both law and fact whether economic changes required a final decree still within its control to be set aside; but that cannot be true of the judge in Section 77 proceeding where the Court is "*brigaded*" with the Interstate Commerce Commission and the latter alone has power to determine the facts. Since subsection (a) expressly provides that the jurisdiction reserved to the Court shall be exercised consistently with Section 77 the residual jurisdiction in cases involving changed economic conditions

would be to determine the existence or non-existence of a *prima facie* case. Whenever such a case is alleged the District Court (if there is an issue of fact) takes evidence limited to that single question. On a reference back to the Interstate Commerce Commission it will be the body to determine the ultimate factual issue and again its factual finding if reached by application of proper standards and not arbitrarily will be conclusive. Of course in its determination of the existence or non-existence of a *prima facie* case the Bankruptcy Court exercises a high judicial function and its decision is reviewable under Section 24a of the National Bankruptcy Act (11 U. S. C. A. 47a). It is for this Court to say what principles should govern the District Court in the exercise of this high judicial function; and here again we come back to the basic concept of justice which would resolve all doubts in favor of revised findings that would avoid a forfeiture.

To summarize the whole argument: we submit that economic changes of vast significance are alleged in the Petitions and are susceptible of proof and as a consequence of these economic changes it is possible—we think probable—that if afforded an opportunity to do so the Interstate Commerce Commission would reappraise the Debtor's earning power on a basis that would permit a sound capitalization large enough to avert some if not all of the tragic forfeitures required by the Plan certified June 14, 1943.

We think that the Interstate Commerce Commission would be grateful for an opportunity to take that humane course for the following reasons:

(1) Commissioner Charles D. Mahaffie so testified before the Senate Committee on Interstate Commerce (Senate Hearings on S 1253, pp. 518; 520; 521).

(2) The Securities and Exchange Commission has taken a strong position against an avoidable forfeiture of equities (Brief in Nos. 609, 610, 612, October Term, 1946).

(3) Congress by its passage of the Wheeler-Reed Bill has taken a definite position that avoidable forfeitures under pending Plans are contrary to the intent of Section 77 (S 1253, Seventy-Ninth Congress).

(4) The President in his Memorandum of Disapproval of the Wheeler-Reed Bill said: "By withholding my signature to this Bill I do not intend to indicate that I favor the pending reorganization plans. I am in agreement with those objectives of the bill which prevent undesirable control of the railroads, either immediately or within a few years, and which prevent forfeitures of securities" (White House Memorandum dated August 13, 1946).

For the foregoing reasons we submit that the stay order was justified in order to hold the *status quo* while vital justiciable questions were awaiting appellate decision pursuant to a lawful appeal; and that the answer to these questions should award the Debtor and the General Mortgage Creditors the right to have the new economic order laid before and considered by the Interstate Commerce Commission to the end that alterations justifiable in the sight of that Commission may be made. We are confident that the Commission action supplemented by the cooperation of the Bankruptcy Court will accomplish most of the salutary objectives of Senate Bill 1253.

Respectfully submitted,

Dated, January 3, 1947.

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[APPENDIX FOLLOWS]

APPENDIX A

TREND OF D&RGW AND CLASS I RAILROADS OPERATING REVENUES COMPARED TREND OF U. S. NATIONAL INCOME 1926—1945

Year	U. S. National Income(1) (millions)	CLASS I RAILROADS Gross Op. Revenue(2) (millions)	CLASS I RAILROADS Gross Op. Revenue(2) Percent of National Income	D&RGW Gross Op. Revenue(3) (millions)	D&RGW Gross Op. Revenue(3) Percent of National Income	D&RGW Gross Op. Revenue(3) Percent of Class I RRs
45	$161,000	$8,902	5.529%	$74.8	0.046%	0.840%
44	160,700	9,437	5.872	70.3	0.044	0.745
43	147,900	9,055	6.122	70.2	0.047	0.775
42	121,600	7,466	6.140	54.5	0.045	0.730
41	96,900	5,347	5.518	31.6	0.033	0.591
40	77,600	4,297	5.537	26.2	0.034	0.610
39	70,800	3,995	5.643	25.1	0.035	0.628
38	64,200	3,565	5.553	23.4	0.036	0.656
37	71,500	4,166	5.827	26.8	0.037	0.643
36	64,900	4,053	6.245	25.6	0.039	0.632
35	55,700	3,452	6.197	20.9	0.038	0.605
34	49,500	3,272	6.610	19.2	0.039	0.587
33	42,300	3,095	7.317	17.1	0.041	0.553
32	40,000	3,127	7.818	17.6	0.044	0.563
31	54,500	4,188	7.684	23.5	0.043	0.561
30	68,900	5,281	7.665	29.7	0.043	0.562
29	83,300	6,280	7.539	34.8	0.042	0.554
28	80,200	6,112	7.621	33.2	0.041	0.543
27	76,400	6,136	8.031	33.1	0.043	0.539
26	76,900	6,383	8.300	34.0	0.044	0.533

National Income: The earnings of the labor and the capital employed in all economic enterprises, both public and private, throughout the nation—including the pay of the Armed Forces. Department of Commerce—*Survey of Current Business.*

Class I Railways: carriers with annual operating revenues above $1,000,000 but not including switching and terminal companies. I. C. C. Statistics.

D&RGW RR Annual Reports.

Research & Statistics
October 7, 1946